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BEFORE THE
POSTAL REGULATORY COMMISSION
WASHINGTON, D.C. 20268-0001

STATUTORY REVIEW OF THE SYSTEM FOR REGULATING RATES AND CLASSES FOR MARKET DOMINANT PRODUCTS	)))	Docket No. RM2017-3

COMMENTS OF THE AMERICAN FOREST & PAPER ASSOCIATION

Pursuant to Order No. 5337, the American Forest & Paper Association ("AF&PA") respectfully submits these comments in response to the Postal Regulatory Commission's ("PRC" or "Commission") revised notice of proposed rulemaking ("Revised NPR") that would modify the system for regulating rates and classes for market dominant products. For the reasons outlined below, AF&PA requests that the Commission offsets a future rate structure that is just and reasonable, and incentivizes the financial interest of the Postal Service as well as the rate payers (the mailing industry, including the paper products companies that supply the raw materials for print communications and packages) to stay in the postal system.

I. American Forest & Paper Association and the Postal Industry

AF&PA serves to advance a sustainable U.S. pulp, paper, packaging, tissue and wood products manufacturing industry through fact-based public policy and marketplace advocacy. AF&PA member companies make products essential for everyday life from renewable and recyclable resources and are committed to continuous improvement through the industry's sustainability initiative - *Better Practices, Better Planet 2020*. The forest products industry accounts for approximately four percent of the total U.S. manufacturing GDP, manufactures nearly $300 billion in products annually, and employs approximately 950,000 men and women. The industry meets a payroll of approximately $55 billion annually and is among the top 10 manufacturing sector employers in 45 states.

Our members and our customers depend heavily on getting our products and messages delivered to the final destination in a secure, timely and cost effective manner. Approximately 39 percent, or nearly $6.5 billion, of the communications papers manufactured by the industry are delivered through the mail system. The success of the Postal Service and the mailing industry is therefore vitally important to the success of the paper industry.

II. Summary

The PRC proposed changes and modifications in the Revised NPR provides a framework that primarily focuses on providing the Postal Service with multiple layers of pricing authority, which effectively puts the onus of unchecked cost coverage on rate payers, while making future rate forecasts more complex and uncertain for mailers. AF&PA agrees with the Commission's original finding that the current system does not meet all the objectives established by Congress, but the Revised NPR should strike a more equitable balance between providing USPS more effective tools for improved financial stability, and offering mail customers a more transparent, stable and predictable rate structure that enables mailers and supply chain participants to forecast costs and plan ahead.

We believe the PRC focus should be USPS financial health based on revenues needed to support ongoing operations, coupled with incentives to continue to reduce costs and become more efficient. The underlying deficit on the USPS balance sheet due to the RHB refunding requirements should be up to Congress to solve. The increases allowed in the Revised NPR will harm the mail supply chain and be self-defeating for the Postal Service. This will result in mailers reducing volume that would otherwise go through the Postal Service network and accelerating their migration to digital channels and alternate delivery methods.

AF&PA recognizes that the PRC was given the complex task of measuring the effectiveness of the system against multiple, and sometimes conflicting objectives. We agree that the financial stability of the USPS was a keystone objective of Congress when the Postal Accountability Enhancement Act ("PAEA") was crafted, but in our opinion the Revised NPR puts too much weight on this one objective to the detriment of the other PAEA objectives. The paper industry knows all too well an environment where market demand is under pressure. The paper industry has experienced the same demand pressure as the Postal Service relative to volume lost to electronic alternatives and changing customer preferences. Like the Postal Service, our industry is characterized by high fixed costs compared to variable operating costs, but paper manufacturers have addressed these obstacles by increasing efficiencies, relentless cost control, and meeting the changing needs of customers. Attempting to price oneself out of the challenge is not a viable solution where customers have multiple options.

AF&PA urges the Commission to reconsider its proposed solution for the financial challenges faced by the USPS. We believe the imposition of postal rates much higher than the rate of inflation will likely further imperil the financial position of the Postal Service by driving away the most valuable and profitable segments of mail. The Postal Service and the Commission must recognize that raising prices is not a successful strategy to address declining demand. We believe that the Commission's proposal will drive a great deal more volume and revenue out of the system, imperiling businesses, jobs, and the Service itself.

III. Argument

A. Supplemental Rate Authority

As part of its review of the financial health of the Postal Service, the Commission completed a three-tiered financial stability analysis to examine whether the Market Dominant ratemaking system under the PAEA was maintaining the financial stability of the Postal Service.

The Commission determined that although short-term stability was achieved under the PAEA, medium-and long-term stability were not. In an attempt to put the USPS on the path to medium-term financial stability, the PRC proposed a supplemental rate authority based on (1) the increase in per-unit cost resulting from the decline in mail density, and (2) the statutory mandated amortization payments for particular retirement costs.

The consumer price index ("CPI") inflation-based price cap was the lynchpin of the PAEA ratemaking system that provided the underlying checks and balances necessary for mailers to reasonably predict their costs, while providing an incentive for the Postal Service to control costs and improve efficiency where it has a monopoly. We feel a price cap that is clearly understood by mail stakeholders must be preserved. Predictability of rates is extremely important for ratepayers as it allows business to make strategic decisions. Since PAEA, rates have generally changed (with the exception of the exigent increase) by predictable amounts (and according to publicly available data) at regular intervals. This has helped mail maintain its value as a business communication tool even as digital media has become ubiquitous. Rate stability and predictability are bedrock requirements for business to stay with mail. The CPI index may not be the best singular reference point for a price cap system, and we agree a revised system should contain some adjustment factor to address changes in operational conditions. But the formulas proposed by the Commission, while well-reasoned, are not easily understood or applied by ratepayers who need to plan future spending.

By providing multiple layers of additional rate authority and thereby the prospect for well above-inflation postal rate increases, the Commission removes the financial pressure required for USPS management and labor to reduce the cost of operations and makes mailers pay for USPS management failures to improve performance. Instead, we believe the PRC should encourage a continued drive to cost efficiency and leverage technology to innovate, reduce cost, or improve the value of mail. If there is to be any additional rate authority, it should be of a defined amount to solve clearly urgent problems. That rate authority should be limited in time and scope and should have clear stipulations and conditions that help move the agency to a more sustainable path.

While we agree that mail volume declines (not necessarily mail density) and retirement related obligations are major contributors to the accumulated USPS financial losses, we do not agree that these factors are completely out of Postal Service control. While it is true that the Postal does not directly control the volume of mail entered into its network, it can influence that volume by the degree to which it delivers value, and meets or exceeds the expectations of its customers relative to that of mail alternatives.

In its approach to restoring the Postal Service's financial stability, the Commission should recognize that legislation with the same goal is a real possibility. While currently pending legislation is not certain to be enacted, the Commission should avoid regulation that is needless, or duplicative of financial rescue mechanisms undertaken by Congress.

B. Performance Based Rate Authority

In the Revised NPR, the Commission created performance-based rate authority of one percentage point granted when both efficiency and service benchmarks are achieved to provide the UPSP with additional revenue with which to achieve financial health. In its original Notice of Proposed Rulemaking (Order #4258), the Commission found that elements under USPS control, such as cost reductions and operational efficiency had not been maximized within the existing rate structure. Before additional rate authority is provided to the Postal Service, AF&PA believes a mechanism should be in place to validate that USPS management has fully implemented all the tools at its disposal to improve its cost structure and meet customer service expectations. For example, the GAO recently estimated that USPS last-mile delivery costs, which represents nearly a third of operating costs, is growing.[1] Last-mile employee work hours, according to the GAO, went from 32 percent of total employee work hours in FY 2008 to 41 percent in FY 2018.[2]

AF&PA appreciates that the PRC has taken a systematic approach to identify mechanisms to help the Postal Service regain financial stability. However, we disagree with the PRC proposal of additional rate authority of one percent as the mechanism to reward the Postal Service for increasing operational efficiency and improve service. We don't think mailers should pay a penalty for USPS cost control efforts. The benefit of cost reduction is bringing more income to the bottom line. We don't know a business model where the reward for controlling costs and becoming more efficient translates into the ability to charge customers more for the product or service. In a competitive marketplace, reducing costs and improving efficiency is a given in order to remain in business. Unless there are mechanisms that incentivize the Postal Service to align institutional costs with expected volume declines, there will be a never-ending cycle of per-unit cost increases leading to subsequent price increases, with the ultimate result being what is commonly understood as the "death spiral" of mail. If service and efficiency factors are included in the Final Rule by the PRC, the Commission should establish empirical criteria to define "efficiency" and "service" so that achievement of those standards can be evaluated objectively. Achievement of "efficiency" or "service" should not be predicated on subjective perceptions.

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[1] United States Government Accountability Office, Report to Ranking Member, Committee on Homeland Security and Governmental Affairs, U.S. Senate, December 2019, GAO-20-190
[2] Ibid

C. Non-Compensatory Product Rate Adjustments

The PRC proposes modifications to the ratemaking system that would require price increases to cover the costs of handling products which attributable cost exceeds revenue, called non-compensatory products. With regard to non-compensatory products, we agree that the system should address the related financial consequences of these products. A number of these products (magazines, catalogs, local newspapers for example) attract customers to the mail box, as well as drive additional business transactions that are delivered through the mail system. We would therefore suggest caution in the approach to "catch up" the cost coverage of these products so that rate increases are so high as to push mailers to other alternatives. As part of the solution, we would also expect the Postal Service to more closely examine opportunities to reduce its costs associated with delivering these products, and to accurately proportion its cost allocation to these products to ensure that current cost estimates are not overstated.

IV. Conclusion

The goal of achieving the long-term financial stability and increased operational efficiency of the Postal Service, while maintaining high-quality service standards will require a more comprehensive set of levers than providing USPS with broader authority to increase prices. While the rate making system created by PAEA works well in meeting some of the objectives established by lawmakers more than ten years ago, it is not perfect, and is subject to improvement. Apart from the onerous retiree health benefits fund (RHBF) requirement, the rate cap system has been an effective tool to balance the business management levers of both the mailers and the Postal Service. The CPI-based cap may need some adjustment, but the ranges of adjustment the PRC proposes put future mail volumes at risk and may have the exact opposite effect of creating financial stability of the Postal Service. The multiple layers of increases as proposed in the Revised NPR get us closer to the pre-PAEA era of a cost-of-service model for setting rates, which may meet the needs of the Postal Service, but not for the rate payers who must foot the bill.

The American Forest & Paper Association maintains our opinion that the financial challenges of the Postal Service cannot be solved through pricing alone. It will take an integrated approach that sets a future rate structure that is just and reasonable and incentivizes the financial interests of the Postal Service with that of the rate payers to stay in the mail. We submit these recommendations to be included by the PRC in its final rule:

1. Retain the CPI cap, and if any additional rate authority is provided, tie any additional rate incentives to clearly defined efficiency and service metrics.

2. Exclude the accelerated prefunding obligation, and USPS debt related to its imposition, from any analysis of whether the current rate setting process adequately ensures the Postal Service's financial stability and its ability to sustain its operations and make prudent capital investments.

3. Leave resolution of the PAEA's infeasible prefunding mandate, and Postal Service's unsustainable financial circumstances related to its imposition, to Congress, the author of the PAEA.

4. Take affirmative measures to ameliorate the cost coverage shortfall of non-compensatory categories but at a pace that moderates the price impact on the related categories.

5. Establishing cost control benchmarks, efficiency metrics, or moving the goal posts of service should be evaluated based on meeting customer expectations as the first priority. We believe setting new performance goals, holding the postal Service accountable, and

establishing the execution plan to achieve service standard results should not rest solely on the PRC, but be a shared responsibility of the PRC and the Postal Board of Governors.

Respectfully submitted,

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